No. 87-1064

In The
Supreme Court of the United States
October Term, 1987

UNITED STATES OF AMERICA,
Petitioner,

v.

PHILIP GEORGE STUART, SR.,
AND MONS KAPOOR,
Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Respondents Philip George Stuart, Sr. and Mons Kapoor by and through their counsel of record hereby present this Brief in Opposition to the Petition of the United States of America for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

I. STATEMENT OF THE CASE

Messrs. Philip George Stuart, Sr. and Mons Kapoor are Canadian citizens and taxpayers, residing in the Province of British Columbia. They received notice that the Internal Revenue Service ("IRS") had issued and served summonses on the Northwestern Commercial Bank in Bellingham, Washington, at the request of the Department of National Revenue, Canada ("Revenue Canada") seeking production of records regarding their financial transactions.[1] Stuart and Kapoor commenced proceedings under 26 U.S.C. § 7609(b)(2) to quash the summonses. The Northwestern Commercial Bank was notified of the pendency of those proceedings and instructed, pursuant to 26 U.S.C. § 7609(d), not to produce any records unless a court order directing it to do so was obtained.

The petitions to quash challenged the enforcement of the summonses on the grounds that they were not issued for a lawful purpose, did not seek information relevant to any inquiry concerning an internal revenue tax of the United States, and that the information could be requested directly under applicable Canadian statutes and regulations.[2] The petitions also alleged that since the summonses were not issued for a lawful purpose, the IRS had therefore failed to follow the required administrative procedures. *United States v. Powell*, 379 U.S. 48, 57-59 (1964). The IRS' responses to the petitions to quash confirmed that the IRS was not claiming or investigating any United States tax liability on the part of either man.

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1 Stuart and Kapoor also received notice that the IRS had issued summonses to another third-party recordkeeper located in the Western District of Washington. Petitions challenging those summonses were filed. The petitions were dismissed as moot after the IRS withdrew those summonses.

2 Stuart's petition also alleged, on the basis of information and belief, that the IRS had failed to give him proper notice under 26 U.S.C. § 7609(a)(1) and that the summons was therefore unenforceable. Subsequently, Stuart learned that notice had been properly given and this objection was withdrawn during oral argument on the IRS' motion for summary enforcement of the summonses.

After receiving the IRS' responses to their petitions to quash, Stuart and Kapoor each served on the IRS a set of interrogatories consisting of six questions seeking limited but highly relevant discovery concerning the criminal nature of Revenue Canada's investigation. The IRS refused to provide any discovery responses whatsoever stating that the letter request for an exchange of information from Revenue Canada was considered "secret" and that the IRS does not allow its own counsel, much less a party challenging a summons, access to such information.

At the same time it filed its objections to providing any discovery, the IRS filed motions for summary enforcement of the summonses. The Affidavits of Thomas J. Clancey, Director of the IRS Foreign Operations District, disclosed that "[t]he Canadian taxing authorities' investigation of [the petitioner] is a criminal investigation, preliminary stage." This disclosure of the criminal nature of Revenue Canada's investigation made the need for the discovery sought by Stuart and Kapoor even more acute. Stuart and Kapoor opposed the motions for summary enforcement.

As both proceedings had previously been referred to Magistrate John L. Weinberg pursuant to 28 U.S.C. § 636 (b)(1) and Magistrate's Rule 4(a)(6), Local Rules of the Western District of Washington, Magistrate Weinberg

heard oral argument on both summary enforcement motions at a single hearing on July 27, 1984. No evidentiary hearing was held at that time or later, the motions being determined only on the basis of the pleadings and records on file.

On September 30, 1985, the Report and Recommendation of Magistrate Weinberg was filed in the Stuart proceeding. The same Report and Recommendation was filed the next day in the Kapoor proceeding. Stuart and Kapoor filed objections to the reports pursuant to Magistrate's Rule 4(c), Local Rules of the Western District of Washington. In addition to renewing the objections made in their memoranda opposing the motions for summary judgment, Stuart and Kapoor raised the issue of whether the Convention Respecting Double Taxation, March 4, 1942, United States-Canada, 56 Stat. 1399, T.S. No. 983 (as amended) ("1942 Treaty") or the Convention with Respect to Taxes on Income and on Capital, September 26, 1980, United States-Canada, *reprinted in* 1 Tax Treaties (CCH) ¶ 1301 (1984), controlled enforcement of the summonses. Stuart's and Kapoor's objections to the Magistrate's Report also requested an opportunity to pursue discovery regarding the equivalency of Revenue Canada's "criminal investigation, preliminary stage" to a referral to the United States Department of Justice.

The two United States District Court judges to whom the petitions had been originally assigned each adopted the Magistrate's Report and Recommendation without modification. Notices of appeal from the final judgments enforcing the summonses were timely filed in each case. The United States Court of Appeals for the Ninth Circuit con-

solidated the two appeals and, on the motion of respondent, stayed enforcement of the summonses pending the outcome of the appeals. The appeals were argued and submitted on December 4, 1986 and the court's opinion was filed on March 24, 1987. The United States petitioned the court for a rehearing with a suggestion for a rehearing en banc. That petition was denied.

Following denial of its petition for rehearing, the United States sought and was granted an extension to file its petition for a writ of certiorari. After reviewing the petition for certiorari, Stuart and Kapoor, through their counsel, informed the clerk of this court that while they opposed the granting of the petition for a writ of certiorari, they expressly waived their right to file a brief opposing the petition. The clerk later relayed the court's interest in receiving from respondents a brief opposing the petition for a writ of certiorari. Respondents sought and were granted an extension of time within which to file this brief.

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II. SUMMARY OF ARGUMENT

The issuance of a writ of certiorari to review a decision of a federal court of appeals is justified only when there are special and important reasons for doing so. The issues raised in the decision for which the United States seeks review are not of sufficient importance to justify discretionary review by writ of certiorari. Moreover, the apparent conflict between *Stuart v. United States of America*, 813 F.2d 243 (9th Cir. 1987) and *United States*

of America v. Manufacturers and Traders Trust Co., 703 F.2d 47 (2d Cir. 1983), is not a "real and embarrassing" conflict that requires this court's intervention to resolve. The factual and legal contexts in which those two cases were decided were sufficiently different to explain the dissimilar outcomes.

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III. REASONS FOR DENYING THE PETITION

1. There Are No Special and Important Reasons for Issuing a Writ of Certiorari

This court need hardly be reminded that its limited resources must be spent carefully in granting discretionary review of decisions of federal courts of appeal. Rule 17.1 of the Rules of the United States Supreme Court sets forth a principle long embodied in the jurisprudence of this court: that there must be "special and important reasons" to justify issuance of a writ of certiorari. *Layne & Bowler Corp. v. Western Wells Works, Inc.*, 261 U.S. 387 (1923). Discretionary review by writ of certiorari should only be granted in cases of true importance to the public and in cases where there is a "real and embarrassing" conflict between circuit courts of appeal. *Id.* 261 U.S. at 393; *accord Rice v. Sioux City Memorial Park Cemetery*, 349 U.S. 70 (1955). One of the arguments made in the petition for a writ of certiorari in support of the claim that special and important reasons for granting the writ exist is simply that the *Stuart* decision incorrectly interprets a treaty. If an allegedly erroneous decision of a circuit court of appeal were sufficient ground for the issu-

ance of a writ of certiorari, this court would likely be overwhelmed with discretionary review cases.

That argument can be disposed of by exploring the sound basis of the *Stuart* majority's interpretation of the request for exchange of information provisions of the 1942 Treaty. The information exchange provisions of the 1942 Treaty describe the information that the receiving state is authorized to provide to the requesting state as information that it is "in a position to obtain under its revenue laws" (Article XIX, par. 1) or "is entitled to obtain under the revenue laws of the United States of America" (Article XXI, par. 1).

The interpretation of a treaty must begin with its language. The clear import of the treaty language controls unless such application will cause a result that is clearly at odds with the intention of the parties to the treaty. *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 180 (1982) (citing *Maximov v. United States*, 373 U.S. 49, 54 (1963)). The clear import of Articles XIX and XXI of the 1942 Treaty is that the Revenue Canada is not entitled to obtain and the Internal Revenue Service cannot expect to obtain or provide information in a fashion inconsistent with United States summons enforcement law. *See U.S. v. A.L. Burbank & Co., Ltd.*, 525 F.2d 9, 13 (2d Cir. 1975), *cert. denied* 426 U.S. 934 (1976).

Prior to passage of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Public Law No. 97-248, 96 Stat. 324 (1982), an "institutional bad faith" defense to summons enforcement had been recognized by the courts and had been the source of considerable litigation. *See United States v. LaSalle Nat'l Bank*, 437 U.S.

298 (1978)[3]; *Donaldson v. United States,* 400 U.S. 517 (1971). In an effort to streamline summons enforcement proceedings, the courts had also severely restricted a taxpayer's right to discovery of facts necessary to challenge the government's *prima facie* case. *See United States v. Church of Scientology,* 520 F.2d 818 (9th Cir. 1975); *United States v. Samuels, Kramer & Co.,* 712 F.2d 1342 (9th Cir. 1983). The *Stuart* majority opinion affirms the application of this aspect of "judicial gloss" to foreign tax convention summons enforcement.[4]

Stuart and Kapoor found themselves in a particularly unfair situation as a result. On the one hand, the affidavits submitted by the government disclosed that the records sought were for use in a "criminal investigation, preliminary stage," which they argued raised sufficient doubt about the lack of a requisite civil purpose. *See United States v. Samuels, Kramer & Co., supra,* 712 F.2d at 1348. On the other hand, the limited discovery rule prevented them from developing a complete record.

Certainly neither the United States nor Canada could reasonably expect that the Internal Revenue Service would be freed from the need to employ process of court to enforce such summonses, nor that in doing so a court would be powerless to prevent abuses of its process. *See United*

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[3] The Petition for a Writ of Certiorari acknowledges that TEFRA adopted the *LaSalle* minority's suggestion for a "bright-line" test of "institutional bad faith." Petition, p. 2, fn. 2.

[4] The *Stuart* majority opinion does not, as the Petition for Writ of Certiorari argues, apply *all* domestic summons enforcement restrictions to tax treaty summons. Petition, p. 8.

States v. Powell, 379 U.S. 48, 58 (1964). The *Stuart* opinion avoids the potential for abuse of the court's process when the domestic summons restrictions on discovery are applied to a treaty summons by requiring an affirmance of lack of referral for criminal prosecution as part of the government's *prima facie* case.[5] It would be an abuse of the court's process to restrict access to essential facts even in a streamlined enforcement proceeding without first requiring an affirmative statement of nonreferral. As the *Stuart* majority opinion suggests, such a rule will further facilitate the enforcement process by setting clear standards. *Stuart,* 813 F.2d at 250.

The government's petition makes two other arguments in an attempt to justify the issuance of the writ. The petition argues that the *Stuart* decision will undermine our foreign relations with Canada and other tax treaty partners. It seems highly unlikely that that result will flow from the *Stuart* decision. The *Stuart* decision assures that foreign tax treaty summonses will be handled in an expeditious manner. *Stuart,* 813 F.2d at 250. If the IRS

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[5] It is difficult to understand how requesting an answer from Revenue Canada to the following questions "injects a new complex issue into summons proceedings." (Petition, p. 14, fn. 8):

> (1) Has Revenue Canada recommended that the Canadian Department of Justice criminally prosecute [the taxpayer] or
>
> (2) Has Revenue Canada requested the summonses at the behest of the Canadian Department of Justice? *Stuart,* 813 F.2d at 249.

In fact, the United States tardily attempted to submit alleged proof of lack of referral to the United States Court of Appeals for the Ninth Circuit. Petition, p. 7, fn. 5.

merely affirms that no referral equivalent to a Justice Department referral has taken place in the requesting country, a taxpayer would then face the burden of overcoming the government's *prima facie* case for enforcement without access to any discovery. *Stuart,* 813 F.2d at 251. This is simply not the sort of interference with the operation of treaty information exchange provisions that is likely to cause a breakdown in our foreign relations.

The third argument offered to justify issuance of the writ is founded on a statistic regarding the number of information exchange requests made. Petition, p. 21. First, the number refers to requests made *or* received. It is likely that the United States is making substantially more than one-half of those requests to other nations, significantly reducing the number of requests to which the *Stuart* decision might be applied. Second, there is no indication of the rate at which the requests received by the United States are honored by the IRS as being in compliance with a particular treaty. Nor is there any suggestion that a significant portion of summonses issued pursuant to such requests are challenged. Third, there is no evidence or argument to indicate that the period chosen for the sample is representative of prior or future activity levels. Finally, for the petition to argue that the apparent differences between the *Stuart* and *Manufacturers* cases will give the appearance of favoring one country over another is to attribute an unwarrantably low level of legal sophistication to our treaty partners.

2. There Is No Real and Embarrassing Conflict Between the Ninth and Second Circuit Courts of Appeals

The *Stuart* and *Manufacturers* decisions do not present a significant conflict between circuit courts of appeal. An example of a truly significant conflict was presented in *Donaldson v. United States,* 400 U.S. 517, 522, fn. 6 (1971), where this court noted that the interpretation of *Reisman v. Caplin,* 375 U.S. 440 (1964), by the Fifth, Second and First Circuits was in conflict with that of the Seventh, Sixth and Third Circuits justifying issuance of a writ of certiorari. Moreover, the different results in *Stuart* and *Manufacturers* can be harmonized by reviewing the factual and legal context in which they were decided.

In *Manufacturers,* the division of Revenue Canada charged with criminal tax prosecution had already considered and rejected a criminal prosecution of the taxpayers. *Manufacturers,* 703 F.2d at 50, fn. 2. By contrast, in *Stuart,* the affidavits submitted in support of the motions to enforce disclosed that the records were being sought in connection with a "criminal investigation, preliminary stage." *Stuart,* 813 F.2d at 245. The availability of discovery to rebut the government's *prima facie* case was not a significant issue in *Manufacturers.* Stuart and Kapoor were faced with a "catch 22" created by the Ninth Circuit Court of Appeals' earlier decision in *United States v. Stuckey,* 646 F.2d 1369, 1373-74 (9th Cir. 1981), *cert. denied,* 455 U.S. 942 (1982), which placed a burden of proof on them yet denied them access to the proof required to meet that burden. *United States v. Stuckey* was a well-intentioned effort to streamline summons enforcement pro-

ceedings by restricting discovery, which discovery had been subject to abuse. The *Stuart* decision corrected the anomaly without unduly interfering with the summary nature of enforcement proceedings.

The *Stuart* majority harmonized their decision with *Manufacturers* by noting TEFRA's impact on the bad faith defense, specifically the effect of 28 U.S.C. § 7602(b), (c). The adoption of a "bright line" test for determining the availability of an administrative summons in a joint civil and criminal investigation is a far cry from the quagmire which that defense presented to the Second Circuit in *Manufacturers*. The difficult inquiry that was required prior to TEFRA, which inquiry might well have offended a treaty partner, is no longer necessary. A simple, inoffensive inquiry is all that is now needed to determine whether a referral analogous to a referral to the Justice Department has taken place. A court considering the enforcement of a tax treaty summons may, under *Stuart,* prevent an abuse of its process without unnecessarily hindering the operation of treaty information exchange provisions. For these reasons, the conflict between the *Stuart* and *Manufacturers* decisions is more apparent than real.

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IV. CONCLUSION

For the reasons stated above, respondents respectfully request that the petition for a writ of certiorari to the United States Court of Appeals for the Ninth Court be denied.

DATED this 8th day of April, 1988.

Respectfully submitted,

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